(8)

No. 91-1677

In the Supreme Court of the United States

OCTOBER TERM, 1992

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

WILLIAM C. BRYSON
Acting Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

25 pp

TABLE OF CONTENTS

	Page
A. An employer's transfer of property in satisfaction of its funding obligation is a "sale or exchange" of the property	2
B. Section 4975(f)(3) is not superfluous if "sale or exchange" is given its ordinary meaning	10
C. The canon of statutory construction that penalty statutes are to be strictly construed has no application to the prohibited transaction rules of Section 4975	14
D. The administrative interpretations of Section 4975 of the Department of Labor and the Internal Revenue Service are entitled to deference	18

TABLE OF AUTHORITIES

Cases:

Commissioner v. *Brown*, 380 U.S. 563 (1965)	3
Commissioner v. *Soliman*, No. 91-998 (Jan. 12, 1993)	2
Commissioner v. *Tufts*, 461 U.S. 300 (1983)	12
Crane v. *Commissioner*, 331 U.S. 1 (1947)	12
Dewsnup v. *Timm*, 112 S. Ct. 773 (1992)	8
Don E. Williams v. *Commissioner*, 429 U.S. 569 (1977)	14
Finley v. *United States*, 490 U.S. 545 (1989)	8
Fraver v. *North Carolina Farm Bureau Mutual Ins. Co.*, 801 F.2d 675 (4th Cir. 1986)	19
Fulman, Inc. v. *United States*, 434 U.S. 528 (1978)	16
Helvering v. *Flaccus Leather Co.*, 313 U.S. 247 (1941)	2
Helvering v. *Hammel*, 311 U.S. 504 (1941)	2
Kenan v. *Commissioner*, 114 F.2d 217 (2d Cir. 1940)	5
Lakeside Irr. Co. v. *Commissioner*, 128 F.2d 418 (5th Cir.), cert. denied, 317 U.S. 666 (1942)	5
Latterman v. *United States*, 872 F.2d 564 (3d Cir. 1989)	16

Cases—Continued: Page

Leigh v. *Engle*, 727 F.2d 113 (7th Cir. 1984), on remand, 619 F. Supp. 154 (N.D. Ill. 1985), 669 F. Supp. 1390 (N.D. Ill. 1987), aff'd, 858 F.2d 361 (7th Cir. 1988), cert. denied, 489 U.S. 1078 (1989) 15
M&R Investment Co. v. *Fitzsimmons*, 484 F. Supp. 1041 (D. Nev. 1980), aff'd, 685 F.2d 283 (9th Cir. 1982) 8, 15
Massachusetts v. *Morash*, 490 U.S. 107 (1989) 19
McWilliams v. *Commissioner*, 331 U.S. 694 (1947) 14
MD Physicians & Associates, Inc. v. *State Board of Ins.*, 957 F.2d 178 (5th Cir.), cert. denied, 113 S. Ct. 179 (1992) 19
Russello v. *United States*, 464 U.S. 16 (1983) 15
Schweiker v. *Hansen*, 450 U.S. 785 (1981) 19
Shea v. *Well Fargo Armored Sevice Corp.*, 810 F.2d 372 (2d Cir. 1987) 19
Tasty Baking Co. v. *United States*, 393 F.2d 992 (Ct. Cl. 1968) 10
The Mansfield Tire & Rubber Co., In re, 942 F.2d 1055 (6th Cir. 1991), cert. denied, 112 S. Ct. 1165 (1992) 16
United States v. *Davis*, 370 U.S. 65 (1962) 2-3
United States v. *Will*, 671 F.2d 963 (6th Cir. 1982) 19
Wood v. *Commissioner*, 955 F.2d 908 (4th Cir.), cert. granted, 112 S. Ct. 2937 (1992), cert. dismissed, 112 S. Ct. 3061 (1992) 3

Statutes and regulations:

Internal Revenue Code (26 U.S.C.):

§ 83 9
§ 83(e)(2) 9
§ 165(e) 12
§ 165(g)(1) 12
§ 195(b) 12
§ 291(a) 12
§ 301(c)(3)(A) 12
§ 302(a) 12

Statutes and regulations—Continued: Page

§ 303(a) 12
§ 304(a)(1) 12
§ 306(a)(1)(B) 12
§ 331(a) 12
§§ 401 *et seq.* 8, 11
§ 404 6
§ 406 15
§ 408(a)(1) 9, 10
§ 412 ..... 4, 6, 7
§ 412(b) 5
§ 415 7
§ 1001(a) 2
§ 1234(a)(2) 12
§ 2044(c) 12
§ 2512(b) 3
§ 2518(c)(1)-(3) 12
§ 2519(a) 12
§ 4941 19
§ 4961(a) 16
§ 4963(b) 16
§ 4963(e) 16
§ 4971 ..... 6, 8, 9
§ 4975 ..... 2, 6, 7, 8, 9, 10, 14, 15, 16, 18, 19
§ 4975(a) 16
§ 4975(b) 16
§ 4975(c) 18
§ 4975(c)(1) 14
§ 4975(c)(1)(A) ..... *Passim*
§ 4975(c)(1)(B) 14
§ 4975(c)(2) 16
§ 4975(c)(3) 18
§ 4975(d)(13) 10, 13
§ 4975(f)(3) 10, 11, 12, 13
§ 6213(a) 16
§ 6601 16
§ 7481(a) 16
Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790 18

Statutes and regulations—Continued: Page

29 U.S.C. 1108 16
29 U.S.C. 1108(e) 10, 13
Treas. Reg. § 1.415-6(b)(4) 7

Miscellaneous:

DOL Advisory Opinion 81-69A (July 28, 1981) 3, 16, 18
DOL Advisory Opinion 90-05A (Mar. 29, 1990) 3, 18
H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. (1974) 4, 8, 12
Rev. Rul. 77-379, 1977-2 C.B. 387 .... 3, 19
Rev. Rul. 81-40, 1981-1 C.B. 508 .... 3, 19
Rev. Rul. 86-105, 1986-2 C.B. 82 5
J. Sherman, *Pension Planning and Deferred Compensation* (1985) 8
S. Rep. No. 383, 93d Cong., 1st Sess. (1973) 9, 12

In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-1677

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

Nothing in respondent's brief demonstrates any error in our contention that the transfer of property in satisfaction of a funding obligation is a "sale or exchange" within the meaning of Section 4975(c)(1)(A). Accordingly, that provision prohibited respondent from satisfying its funding obligations by transferring truck terminals and real estate to the Pension Trust, rather than paying in cash.[1]

[1] Respondent does not acknowledge that there is anything unusual about its form of payment. But most persons would be quite surprised (and would almost surely raise objections) if a debtor suggested that, instead of paying in cash, it would satisfy an obligation by transferring ownership of a truck terminal or a parcel of real estate.

A. *An employer's transfer of property in satisfaction of its funding obligation is a "sale or exchange" of the property.*

1. Respondent contends that "sale or exchange" is interpreted broadly under the income tax provisions of the Code "[b]ecause the finding of a 'sale or exchange' is essential to the recognition of gain or loss." Br. 24. Hence, according to respondent, the fact that a transfer of property in satisfaction of an obligation is a "sale or exchange" of the property under the income tax provisions of the Code has "little relevance" (Br. 25) under Section 4975.

Contrary to respondent's premise, gain or loss ordinarily is recognized on "the sale *or other disposition* of property," not simply dispositions constituting sales or exchanges of property. 26 U.S.C. 1001(a) (emphasis added). Nor were the many decisions of the courts over the last fifty years holding that a transfer of property in satisfaction of an obligation constitutes a "sale or exchange" based on an unusually broad interpretation of that phrase. Those decisions clearly comport with the well established rule that the words "sale" and "exchange" as used in the Internal Revenue Code are to be given their "ordinary meaning." *Helvering* v. *Flaccus Leather Co.*, 313 U.S. 247, 249 (1941); see also *Commissioner* v. *Soliman*, No. 91-998 (Jan. 12, 1993), slip op. 5 ("[i]n interpreting the meaning of the words in a revenue act, we look to the ' "ordinary everyday senses" ' of the words").[2]

[2] *Helvering* v. *Hammel*, 311 U.S. 504 (1941), which respondent cites for the proposition that the word "sale" may have many different meanings (Br. 25), is not to the contrary. In that case, this Court declined to depart from the "usual meaning" of the word "sale" as including gain or loss realized on the foreclosure of property because the "usual meaning" did not produce an absurd result or one that would thwart the obvious purpose of the statute. 311 U.S. at 510-511. Respondent's assertion that this Court held in *United States* v. *Davis*, 370 U.S. 65 (1962), that a division of property was treated as a "sale or exchange" for income tax purposes but "was *not* treated as a 'sale or exchange' under the gift and estate tax statutes" (Br. 25) is incorrect. To be sure, this Court stated in *Davis* that "the language and considerations ingrained in the gift and estate tax statutes" were not relevant under the income tax provisions of the Internal Revenue Code. 370 U.S. at 69 n.6. But that was because whether a transaction is a gift depends on whether the property is transferred for less than an "adequate and full consideration in money or money's worth" (26 U.S.C. 2512(b)), not on whether the transaction is a "sale or exchange" or other type of taxable disposition under the income tax provisions of the Internal Revenue Code.

The pertinent administrative interpretations similarly have given "sale or exchange" its ordinary meaning under the excise tax provisions of the Internal Revenue Code, including Section 4975(c)(1)(A). See Rev. Rul. 77-379, 1977-2 C.B. 387; Rev. Rul. 81-40, 1981-1 C.B. 508; DOL Advisory Opinion 81-69A (July 28, 1981); DOL Advisory Opinion 90-05A (Mar. 29, 1990). Indeed, the court of appeals in *Wood* v. *Commissioner*, 955 F.2d 908, 913 (4th Cir.), cert. granted, 112 S. Ct. 2937 (1992), cert. dismissed, 112 S. Ct. 3061 (1992), found "no instance when the term 'sale or exchange' has been used or interpreted not to include transfers of property in satisfaction of indebtedness" (Pet. App. 28a), and respondent has cited none.[3]

Nor does respondent plausibly explain why a direct transfer of property to a pension plan in satisfaction of a funding obligation should be treated differently from the transfer of cash to a pension plan, followed by the use of the cash to purchase property from the employer, a transaction that no one disputes would be prohibited by

[3] See also *Commissioner* v. *Brown*, 380 U.S. 563, 570-571 (1965), where this Court stated that "[a] 'sale' * * * is a common event in the non-tax world; and since it is used in the Code without limiting definition and without legislative history indicating a contrary result, its common and ordinary meaning should at least be persuasive of its meaning as used in the Internal Revenue Code."

Section 4975(c)(1)(A). Under respondent's interpretation, however, the prohibition against "sales or exchanges" between employers and pension plans ~~may be circum~~vented by the simple expedient of not paying cash to the plan to satisfy the employer's funding obligation, but instead transferring to the plan the property that the employer desires to sell.[4]

2. Respondent further contends (Br. 8) that, since Section 412 does not state that pension plan contributions must be made in cash, it owed no "monetary" or "dollar" funding obligation to the plan. Hence, according to respondent, its transfers of property to the Pension Trust were not sales or exchanges of the properties transferred, because the transfers were not made in satisfaction of an obligation to transfer cash to the Pension Trust. Respondent cites no authority for the remarkable proposition that a transfer of property in satisfaction of an obligation is not a "sale or exchange" of the property unless the obligation is expressly required to be paid in cash.

In any event, contrary to respondent's assertion, Section 412 clearly states a plan's funding obligation in monetary or dollar terms. Section 412(a) provides that a plan shall have satisfied the minimum funding standard so

[4] Respondent's citation (Br. 30 n.9) to the "indirect" transactions described in the legislative history underscores the error of respondent's position. For example, as respondent concedes (*ibid.*), an employer's sale of property to a mutual fund under an arrangement in which the plan then invests in the mutual fund is a prohibited transaction. See H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 309-310 (1974). Such a transaction is the functional equivalent of using the plan's money to facilitate the sale of the employer's property. Similarly, the contribution of cash to a pension plan in satisfaction of a funding obligation and the simultaneous use of the cash to purchase property from the employer is the functional equivalent of the sale of the employer's property.

long as the plan does not have an accumulated funding deficiency. Whether a plan has an accumulated funding deficiency is determined by offsetting the various credits to, and charges against, the plan trust. Under Section 412(b), respondent's funding standard account is charged with the "sum" of the "amount[s]" necessary to fund the plan, and is credited with the "sum" of the "amount[s]" transferred to the plan. The terms "sum" and "amount[s]" plainly denote a monetary obligation. Respondent thus was required to fund the Pension Trust so as to satisfy the dollar amount of the obligation it owed to the Trust.

Moreover, it is well established that the transfer of property in satisfaction of an obligation is a sale of the property for the amount of the obligation satisfied, whether the obligation must be paid in cash or whether the debtor has the choice of paying the obligation in cash or transferring property of equivalent value in satisfaction of the obligation. See *Kenan* v. *Commissioner*, 114 F.2d 217, 219-220 (2d Cir. 1940); Rev. Rul. 86-105, 1986-2 C.B. 82, 83; see also *Lakeside Irr. Co.* v. *Commissioner*, 128 F.2d 418, 418-419 (5th Cir.), cert. denied, 317 U.S. 666 (1942). Indeed, the courts of appeals in both this case and *Wood* (Pet. App. 7a, 42a) agreed that the transfer of property to a pension plan in satisfaction of a funding obligation is a "sale or exchange" under the usual meaning of those words.[5]

3. Respondent argues further that "the statutory structure of ERISA" shows that "a 'contribution' of property * * * is not a prohibited 'sale or exchange.'" Br.

[5] Respondent also argues (Br. 26) that, since money is property, a transfer of money in satisfaction of a funding obligation must be a prohibited sale of the money under the government's interpretation of Section 4975(c)(1)(A). As with many of respondent's contentions, this novel argument overlooks the fact that "sale or exchange" is to be given its ordinary meaning. A transfer of money (*i.e.*, United States currency) in satisfaction of an obligation would not be considered a sale of the money in common usage.

6. According to respondent, matters pertaining to the funding of a defined benefit pension plan are governed by Sections 404 (allowing deductions for plan contributions), 412 (establishing minimum funding obligations), and 4971(a) (imposing an excise tax on funding deficiencies), which permit—or at least do not explicitly prohibit—contributions of property to pension plans. Br. 7-10, 36-39. In respondent's view, the only purpose served by Section 4975 is "to protect the assets of a plan once those assets have been contributed." Br. 11. Thus, according to respondent, Section 4975(c)(1)(A) only "prevents an employer from selling property to a pension plan in exchange for plan assets." Br. 14.

Respondent's restrictive reading of Section 4975 is erroneous. By its terms, Section 4975(c)(1)(A) prohibits "*any* direct or *indirect* * * * sale or exchange * * * of any property between a plan and a disqualified person." The statutory language does not except a transaction that is a "sale or exchange" within the accepted meaning of those words on the basis that the "sale or exchange" occurs in connection with the funding of a plan. Furthermore, respondent's view cannot be squared with Congress's objective in enacting Section 4975, which was to bar categorically transactions that carry a high potential to harm pension plans.[6] Respondent's interpretation of

[6] As we show in our opening brief (at 19-20), this case illustrates one aspect of the potential for abuse, since respondent contributed to the Pension Trust truck terminals that were difficult to sell. Respondent notes (Br. 1) that, in this case, by the time all of the truck terminals were ultimately sold, the plan received net amounts greater in the aggregate than the fair market value of the properties on the dates of contribution. But that does not justify the contribution of illiquid property that took the Trust three and one-half years to sell; respondent placed the risk on the Trust that the property would depreciate in value during that period and shifted the selling costs of the properties to the Trust. Moreover, if respondent had contributed cash to the plan, the plan could have invested it during the time that it was trying to sell the

Section 4975(c)(1)(A) would open the door to many of the abuses that Section 4975(c)(1)(A) was intended to prohibit. See *Wood* v. *Commissioner*, *supra*, Pet. App. 23a (rejecting the contention that, under the statutory structure, Section 4975 "applies only to the *operation and management* of a defined benefit plan, and does not pertain to *contributions* of property to fund the plan").

Furthermore, contrary to respondent's contention (Br. 9-10), there is nothing inconsistent in allowing deductions based on the transfer of property in payment of a deductible expense and treating the same transfer of property as a "sale or exchange" of property subject to excise tax under Section 4975. Treasury Regulations explicitly indicate that a contribution of property may pass muster under Section 415 and hence be deductible under Section 404 even though the transaction is a prohibited transaction. See Treas. Reg. § 1.415-6(b)(4). If a tax deduction were not allowed to an employer who transferred property in satisfaction of a funding obligation, that employer would be put in a worse position than one who sold property to a pension trust and then used the proceeds to make a tax deductible contribution to satisfy its funding obligation. As we have argued, there is no reason to distinguish between a direct and an indirect sale. Similarly, Section 412, which establishes minimum funding *standards*, is not addressed to the *manner* in which a pension plan is funded at all, and thus it neither

truck terminals. Although, as respondent observes (Br. 37), it may ultimately bear any losses suffered by the plan as a result of respondent's failure to contribute cash, because that cost may eventually be reflected in an increase in its funding obligation, the fact remains that respondent deferred to a future year its obligation to fund the plan to that extent. And as we point out in our opening brief (at 21), if respondent encounters serious financial problems while deferring payment, the shortfall may be borne by the PBGC and plan participants. See also PBGC Amicus Br. at 3-4.

specifically authorizes nor specifically prohibits contributions of property to pension plans.[7]

Moreover, it is not surprising that the rules set out in 26 U.S.C. 401 *et seq.* do not by their terms punish prohibited transactions. In general, those provisions in the Tax Code govern the tax qualification of pension plans, and Congress did not want pension plans to lose their tax-qualified status, which would have unfavorable consequences for all plan participants, on account of a fiduciary breach such as the sale of property to a plan by an insider such as an employer. See. *e.g.*, H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 321-322 (1974). Other provisions—including the prohibited transaction provisions—are aimed at preventing and correcting fiduciary breaches.

Respondent's reliance on Section 4971 is similarly misplaced. Respondent points out that, since Section 4971

[7] Respondent also asserts (Br. 34) that, since contributions of property to pension plans were common prior to the enactment of ERISA, Section 4975(c)(1)(A) may not be interpreted to prohibit contributions of property in satisfaction of funding obligations absent legislative history indicating an intention to change pre-ERISA law. Unlike the cases on which respondent relies (*Dewsnup* v. *Timm*, 112 S. Ct. 773, 779 (1992); *Finley* v. *United States*, 490 U.S. 545, 554 (1989)), however, ERISA constituted "the most sweeping revision of pension law since pension law began" (J. Sherman, *Pension Planning and Deferred Compensation* § 1.01, at 2 (1985)), and imposed a comprehensive remedial scheme designed to protect the pensions and other benefits of employees (*M&R Investment Co.* v. *Fitzsimmons*, 484 F. Supp. 1041, 1054 (D. Nev. 1980), aff'd, 685 F.2d 283 (9th Cir. 1982)). In any event, the reason a transfer of property in satisfaction of a funding obligation was not prohibited under prior law was that transactions between disqualified persons and pension plans, including sales and exchanges, were restricted only by the requirement that the transaction reflect a fair consideration under an arm's-length standard of dealing between the parties. But, as we show in our opening brief (at 12-13), Congress enacted Section 4975 to replace the arm's-length standard with a set of categorical rules.

imposes an excise tax on accumulated funding deficiencies, it follows that if an employer overstates the value of property contributed to a plan, the employer would be subject to excise tax under Section 4971. Br. 9, 37. According to respondent, it follows that such a transaction must not be one prohibited by Section 4975. But *every* transaction prohibited by Section 4975 *could* cause a funding deficiency if not conducted at arm's-length. Hence, the fact that a transaction could cause a funding deficiency that would be subject to excise tax under Section 4971 provides no basis for determining whether it is prohibited by Section 4975. Moreover, respondent's position would do violence to the purpose of Section 4975—to eliminate the need for case-by-case evaluations of transactions between disqualified persons and pension plans, so as to prevent disqualified persons from inflicting harm on a pension plan before that harm occurs. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973).[8]

[8] Respondent also suggests (Br. 10 n.2) that 26 U.S.C. 83, the income tax provision that governs property transferred in connection with the performance of services, contemplates that employers would make non-cash contributions to qualified plans. But that does not undermine our position, because we recognize that unencumbered property may be transferred to defined contribution plans when the transfer does not fulfill a funding obligation. Furthermore, Section 83 ordinarily results in the delay of employer deductions until the value of the property transferred is included in the income of the employee. A principal tax benefit provided to qualified plans, however, is that employer contributions are deductible when made even though the employee is not taxed until he begins receiving retirement benefits. Hence, it is hardly surprising that Congress provided in Section 83(e)(2) that the provision does not apply to transfers of property to or from qualified plans.

Respondent similarly asserts (Br. 12) that, since Section 408(a)(1) specifically prohibits contributions of property to individual retirement accounts (IRAs), the absence of a provision in Section 4975 or elsewhere specifically prohibiting contributions of property to other types of pension plans indicates that Congress did not intend to prohibit

B. Section 4975(f)(3) is not superfluous if "sale or exchange" is given its ordinary meaning.

There is no merit to respondent's argument (Br. 16-19) that Section 4975(f)(3), the provision barring transfers of *mortgaged* property to pension plans, is rendered superfluous by our interpretation of Section 4975(c)(1)(A). As we explain in our opening brief (at 24-26), the primary flaw in that argument is that it overlooks the existence of defined *contribution* pension plans, such as profit-sharing plans. While the contribution of property to a defined *benefit* pension plan, such as the plans sponsored by respondent, is generally a prohibited "sale or exchange" of the property under Section 4975(c)(1)(A),[9] many donations to defined contribution plans do not extinguish any funding obligation. Indeed, some defined contribution plans do not even have funding obligations.

Thus, the donation of property worth, for example, \$80,000, to a defined contribution plan is not a prohibited transaction if it is in addition to any funding obligation the employer may have. That is so, even though, under pre-ERISA cases such as *Tasty Baking Co.* v. *United States*, 393 F.2d 992, 995 (Ct. Cl. 1968), the transaction would constitute a "sale or exchange" under the income tax laws, since the property would be contributed in exchange for

---

transfers of property to such plans. Once again, respondent ignores that the government has never contended that Section 4975 bars all contributions of property to pension plans. Moreover, there are no funding obligations of any kind in the case of IRAs. Thus, Section 408(a)(1) establishes a rule for IRAs that is stricter than the rules that apply to other types of defined contribution plans — property, including unencumbered property, may not be contributed to IRAs, even though the contribution does not satisfy a funding obligation.

[9] The contribution of property to a defined benefit pension plan is not prohibited if the transaction satisfies the exemption requirements for employer real property and securities set out in 26 U.S.C. 4975(d)(13) and 29 U.S.C. 1108(e).

the employees' labor. Whatever the relevance of those cases after the enactment of ERISA, which contains detailed provisions setting out the tax treatment of contributions to qualified pension plans (see 26 U.S.C. 401 *et seq.*), Section 4975(c)(1)(A) does not prohibit sales or exchanges between the employer *and its employees*. Rather, it prohibits sales or exchanges between *pension plans* and sponsoring employers. In other words, a defined contribution plan has not been a party to a "sale or exchange" if an employer contributes property where there is not a funding obligation owed to the plan. Accordingly, Section 4975(f)(3) is not rendered superfluous by our reading of Section 4975(c)(1)(A) since, in our view, Section 4975(f)(3) prohibits contributions of *mortgaged* property even if the contribution does not satisfy a funding obligation and hence is not a prohibited "sale or exchange" under Section 4975(c)(1)(A).

Respondent does not dispute the fact, overlooked by the court of appeals in this case, that defined contribution plans exist and that employers make contributions to those plans that do not satisfy any funding obligation. However, respondent suggests that a contribution of mortgaged property would always constitute a "sale or exchange" between an employer and a plan even in the absence of Section 4975(f)(3), and contends on that basis that Section 4975(f)(3) is rendered superfluous by our reading of the statute. That argument is flawed. For example, if an employer contributed property that was worth \$100,000 but subject to a \$20,000 mortgage to a defined contribution plan, the net effect would be the same as if the employer contributed property worth \$80,000 to a plan. There is no good reason why it should be treated differently for purposes of the prohibited transaction rules. Accordingly, such a contribution would not be barred by Section 4975(c)(1)(A), but it would be barred by Section 4975(f)(3), which provides that the transfer of

mortgaged property by a disqualified person to a plan "shall be treated as a sale or exchange."[10] That, in turn, shows that Section 4975(f)(3) is not rendered superfluous by our reading of Section 4975(c)(1)(A).

Moreover, the language in Section 4975(f)(3) providing that the contribution of mortgaged property "shall be treated as a sale or exchange" undercuts respondent's position. That terminology—"shall be treated as"—is used throughout the Internal Revenue Code to denote special treatment. See, *e.g.*, Sections 165(e), 165(g)(1), 195(b), 291(a), 301(c)(3)(A), 302(a), 303(a), 304(a)(1), 306(a)(1)(B), 331(a), 2044(c), 2518(c)(1)-(3), and 2519(a). (See also "deemed," *e.g.*, Section 1234(a)(2).) Thus, by directing that contributions of mortgaged property "shall be treated as" sales or exchanges, Congress showed that it did not view every contribution of mortgaged property as necessarily *being* a "sale or exchange."

Similarly, the legislative history shows that Congress did not view every contribution of mortgaged property as constituting a "sale or exchange." The committee reports described Section 4975(f)(3) by stating that "[t]his rule prevents circumvention of the prohibition on sale by mortgaging the property before a transfer to the trust." S. Rep. No. 383, 93d Cong., 1st Sess. 98 (1973); see also H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 308 (1974). Congress plainly thought that the contribution of mortgaged property was not, in and of itself, a "sale or

[10] Of course, the amount of the mortgage would be taken into account in determining the proper tax treatment of the contribution by the employer. The cases petitioner cites, *Commissioner* v. *Tufts*, 461 U.S. 300 (1983), and *Crane* v. *Commissioner*, 331 U.S. 1 (1947), support that conclusion, but only that conclusion. Neither case involved a pension plan and neither suggests that the contribution of mortgaged property to a pension plan should always (or ever) be characterized as a "sale or exchange" between the plan and the employer rather than between the employees and the employer.

exchange" between an employer and a plan, since the reports said that, in the absence of Section 4975(f)(3), an employer might be able to "circumvent[ ]" the prohibition on sales. Furthermore, the fact that Congress spoke of "treating" transfers of mortgaged property as sales or exchanges and of avoiding "circumvention" of the prohibition on sales to pension plans by insiders also shows that respondent and the court of appeals err insofar as they contend that Section 4975(f)(3) provides the *definition* of "sale or exchange." Rather, that language shows that Section 4975(f)(3) provides a rule that supplements, rather than replaces, the prohibition set out in Section 4975(c)(1)(A).

Respondent ignores our argument (Br. 27) that, if Congress had wanted to allow employers to satisfy their funding obligations by contributing unencumbered property to pension plans, it would have done so in Section 4975(d), the exemption provision, rather than by negative implication from the "special rule" in Section 4975(f)(3). As we noted, Congress created an exemption for certain employer contributions of property in Section 4975(d)(13). See also 29 U.S.C. 1108(e). This narrow exemption, which is inapplicable here, would have been unnecessary if Section 4975(c)(1)(A) did not generally prohibit contributions of unencembered property.

In short, respondent mistakenly argues that our construction of Section 4975(c)(1)(A) renders Section 4975(f)(3) superfluous and also reads the "special rule" set out in Section 4975(f)(3) out of its context. That provision is a prophylactic measure that keeps mortgaged property from being contributed to pension plans. It cannot be read as the statutory *definition* of "sale or exchange"—which it clearly is not (it is a "special rule"). Moreover, respondent erroneously reads Section 4975(f)(3) in a manner that emasculates Section 4975(c)(1)(A). That is, as we explain in our opening brief (at 26), in respondent's view employers

are free to fulfill their funding obligations by contributing property rather than cash to pension plans, despite the high potential for abuse inherent in such transactions, as long as they do not contribute mortgaged property. Respondent has suggested no reason why Congress would have been so protective of pension plans with respect to encumbered property—barring any such contribution, even those that are plainly beneficial—while at the same time allowing employers to satisfy their funding obligations by contributing unencumbered property despite the fact that such property may be overvalued or difficult to sell or both.[11]

C. The canon of statutory construction that penalty statutes are to be strictly construed has no application to the prohibited transaction rules of Section 4975.

Respondent's contention that Section 4975 should be narrowly construed because it imposes a penalty is refuted by the language of the statute. Section 4975(c)(1) states in the broadest possible terms that "any direct or indirect" transactions of the types described are prohibited. See *McWilliams* v. *Commissioner*, 331 U.S. 694 (1947); see

[11] Respondent also errs in asserting (Br. 36) that Section 4975(c)(1)(B), which, among other things, prohibits disqualified persons from borrowing money from pension plans, shows that our reading of Section 4975(c)(1)(A) is mistaken. According to respondent, since an employer's own promissory note is property, an employer's transfer of its promissory note to a pension plan in satisfaction of a funding obligation would constitute a sale of the note under Section 4975(c)(1)(A); that suggests, respondent continues, that our reading of Section 4975(c)(1)(A) is overbroad, because Section 4975(c)(1)(B) prohibits such borrowing. The primary problem with the argument is that an employer's transfer of its own promissory note to a pension plan is not a payment that satisfies its funding obligation. An employer's own promissory note is simply a promise to pay. *Don E. Williams Co.* v. *Commissioner*, 429 U.S. 569 (1977)

also *Wood* v. *Commissioner*, *supra;* Pet. App. 31a ("the very language of the section indicates that the term 'sale or exchange' should not be interpreted restrictively"). None of the cases on which respondent relies for the general proposition that penalty statutes ordinarily are narrowly construed (Br. 27-28) dealt with a statute whose language shows that it was intended to be broadly construed. Cf. *Russello* v. *United States*, 464 U.S. 16, 29 (1983) (rule of lenity applies only if the court cannot otherwise construe a statute).

Furthermore, construing Section 4975 narrowly would do violence to the purpose of that provision. Section 4975 and its counterpart in the Labor provisions of ERISA were enacted to ensure the integrity of pension plans by eliminating the possibility that transactions between disqualified persons and pension plans might not be at arm's-length, or otherwise might not be in the best interest of the plan. Thus, consistent with the broad language and purpose of the prohibited transaction provisions, the Seventh Circuit held that Section 406 of ERISA (the Labor counterpart of Section 4975 of Internal Revenue Code) should be interpreted "broadly in light of Congress' concern with the welfare of plan beneficiaries." *Leigh* v. *Engle*, 727 F.2d 113, 126 (7th Cir. 1984), on remand, 619 F. Supp. 154 (N.D. Ill 1985), 669 F. Supp. 1390 (N.D. Ill. 1987), aff'd, 858 F. 2d 361 (7th Cir. 1988), cert. denied, 489 U.S. 1078 (1989); see also *M&R Investment Co.* v. *Fitzsimmons*, 484 F. Supp. at 1054. The Seventh Circuit added that, since the entire statutory scheme of ERISA demonstrates Congress's overriding concern with the protection of plan beneficiaries, "we would be reluctant to construe narrowly any protective provisions of the Act." 727 F.2d at 126. A narrow construction of Section 4975 would serve only to benefit insiders who desire to engage in potentially abusive transactions with pension plans at the expense of both plan beneficiaries and the PBGC. The

general canon of construction that penalty statutes are narrowly construed does not override the language of Section 4975(c)(1)(A) and Congress's purpose in enacting it.

In addition, the strict construction principle is simply not applicable where, as here, the tax imposed is one that can easily be avoided. See *Fulman, Inc.* v. *United States*, 434 U.S. 528, 533 n.8 (1978). Respondent could have avoided the excise tax of Section 4975 in this case either by (1) heeding the Department of Labor's 1981 administrative ruling that a transfer of property in satisfaction of a funding obligation is a prohibited sale or exchange (DOL Advisory Opinion 81-69A); or (2) seeking an administrative exemption under the procedures of 29 U.S.C. 1108 and 26 U.S.C. 4975(c)(2). Indeed, the bulk of the excise tax imposed by Section 4975 may easily be avoided even *after* a disqualified person has engaged in a prohibited transaction.[12]

Furthermore, Section 4975 is an excise tax, and has been held *not* to constitute a penalty tax for various tax and non-tax purposes. See *Latterman* v. *United States*, 872 F.2d 564, 568-570 (3d Cir. 1989) (excise tax imposed by Section 4975(a) was not a "penalty," but a "tax," for purposes of applying Section 6601 of the Code, a provision that provides for the accrual of interest on, *inter alia*, underpayments of tax); *In re The Mansfield Tire & Rubber Co.*, 942 F.2d 1055 (6th Cir. 1991), cert. denied *sub nom. Krugliak* v. *United States*, 112 S.Ct. 1165 (1992) (excise taxes imposed by Code Section 4971 are "taxes" rather than "penalties" under the Bankruptcy Code).

---

[12] The first tier tax is an annual one of five percent of the amount involved. Section 4975(a). The heavier second tier tax of 100% of the amount involved ordinarily may be avoided entirely by timely correction of the transaction after the completion of litigation concerning the taxpayer's liability for that tax. See Sections 4975(b), 4961(a), 4963(b) and (e), 6213(a), 7481(a).

Thus, there is no basis for according "sale or exchange" in Section 4975(c)(1)(A) a narrow construction at odds with the ordinary, long-accepted meaning of those words.

Finally, respondent asserts (Br. 37-39) that the statute should be construed narrowly because the policy concerns of the government are addressed by other provisions, and because there are "several" countervailing policy considerations. Respondent, however, points to only one such purported policy consideration. Thus, respondent asserts that defined benefit plans are better for employees than defined contribution plans, and that, since the contribution of property to a defined contribution plan is not necessarily a prohibited transaction, the Commissioner's position here effectively encourages employers to establish defined contribution plans. But an employer that wishes to use property to satisfy its funding obligation to a defined benefit plan need only sell that property and contribute the cash proceeds to the plan to avoid the prohibited transaction rules. Only if the employer cannot find a buyer for the property will the employer be in a worse position than if it contributed the property directly to the plan (except for having to bear the costs of sale immediately). That, however, merely points up why the contribution of property to a plan in satisfaction of a funding obligation should be a prohibited transaction. Furthermore, respondent's suggestion that other statutes address the policy concerns of the Commissioner is wrong, as has been discussed above (pp. 8-9), and in our opening brief (at 18-21). Indeed, even respondent ultimately is forced to admit (Br. 38) that "[p]olicy considerations in this case * * * cut both ways."

In our view, however, no policy consideration favors respondent. That is, there is no good reason why employers should not generally sell property themselves and contribute the proceeds to satisfy their pension obligations. The contrary rule that respondent favors

would allow employers to overvalue the property they contribute and transfer the transaction costs of sale to pension plans. Of course, the temptation to do so would be greatest when the employer is encountering financial difficulty, as the PBGC explains in its amicus brief. That, in turn, makes it likely that the PBGC would end up with the burden of converting such property into cash to pay pension benefits, and that the plan would not have the assets required to pay the benefits that were promised.

D. The administrative interpretations of Section 4975 of the Department of Labor and the Internal Revenue Service are entitled to deference.

Respondent's contention that the administrative interpretations of the Department of Labor and the Internal Revenue Service are not entitled to deference is based largely on its assertion that the Internal Revenue Service has not consistently interpreted Section 4975 to prohibit the transfer of property in satisfaction of a funding obligation. Br. 30-33, 39-40. Since 1978, however, the Department of Labor, not the Internal Revenue Service, has had interpretive authority with respect to Section 4975(c) (with the exception of Section 4975(c)(3), dealing with the furnishing of goods, services, or facilities between a plan and a disqualified person). Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790. The Department of Labor's advisory opinions have consistently held since 1981 that the transfer of property in satisfaction of a funding obligation is a prohibited transaction. DOL Advisory Opinion 81-69A, *supra*; DOL Advisory Opinion 90-05A, *supra*. Accordingly, as that of the agency statutorily charged with interpreting Section 4975(c)(1)(A), the Department of Labor's consistent administrative position that a transfer of property in satisfaction of a funding

obligation is a prohibited sale or exchange is entitled to deference.[13]

Further, as we observed in our opening brief (at 31-32), it is instructive that the Internal Revenue Service has accorded the same meaning to the phrase "sale or exchange" in interpreting Section 4941 of the Internal Revenue Code, the provision upon which Section 4975 was modeled. See Rev. Rul. 81-40, 1981-1 C.B. 508; Rev. Rul. 77-379, 1977-2 C.B. 387. To be sure, as respondent notes (Br. 31-33), the Internal Revenue Manual currently states that if a plan permits contributions to be made in property, then the contribution of property "may" be a prohibited transaction, and previously stated that contributions of property were not prohibited. But the Internal Revenue Manual is not intended to be a statement of policy. The Manual only provides general guidance to audit agents, and it in no way either binds the IRS or carries the force of law. See *United States* v. *Will*, 671 F.2d 963, 967 (6th Cir. 1982) (Internal Revenue Manual "does not confer any rights upon the taxpayer"); cf. *Schweiker* v. *Hansen*, 450 U.S. 785, 789 (1981) (Social Security Administration's 13 volume Claims Manual has "no legal force"). Indeed, while basing its argument on the Manual, respondent ultimately

---

[13] Respondent's unsupported assertion that the Department of Labor's interpretation is not entitled to deference because its advisory opinions are binding only on the parties is without merit. Advisory opinions of the Department of Labor constitute official expressions of the Department's positions respecting ERISA and have been so treated by the courts. See, *e.g.*, *Massachusetts* v. *Morash*, 490 U.S. 107, 118 n.14 (1989); *Fraver* v. *North Carolina Farm Bureau Mutual Ins.*, 801 F.2d 675, 677-678 (4th Cir. 1986); *Shea* v. *Well Fargo Armored Service Corp.*, 810 F.2d 372, 376 (2d Cir. 1987); *MD Physicians & Associates, Inc.* v. *State Board of Ins.*, 957 F.2d 178, 186 n.9 (5th Cir.), cert. denied, 113 S.Ct. 179 (1992). Consequently, opinions expressed in such pronouncements fall within the rule that an agency's construction of a statute that it is charged with administering is entitled to considerable weight.

"acknowledges that the Internal Revenue Manual is not legally binding." Br. 33. Moreover, as noted, the Department of Labor, not the IRS, has primary responsibility for administering the prohibited transaction rules.

In any event, the administrative position of the Service is clear, as is evidenced by its position in this case and *Wood*. That position is consistent with the settled meaning of the phrase "sale or exchange" and the administrative position of the Department of Labor. The position of both agencies, as well as the PBGC, is that the transfer of property to a defined benefit plan in satisfaction of the transferor's funding obligations is a prohibited transaction under Section 4975(c)(1)(A).

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

WILLIAM C. BRYSON
Acting Solicitor General

JANUARY 1993